

Chapter 3

Regulation and oversight of the current consumer protection system

3.1 Australian financial services licensees are required by law to meet particular product and service standards, such as disclosure of terms and conditions and their own remuneration structures, as well as to ensure, in particular instances, that they are working in a client's best interests. In instances where consumers believe that an entity has engaged in misconduct or behaved unethically, financial services licensees must have their own internal dispute resolution procedures in place that meet particular regulatory requirements, and they must be members of an approved external dispute resolution (EDR) scheme.

3.2 This chapter outlines the key legislation that provides consumer protections in the banking, insurance and financial sectors. It also discusses the government bodies responsible for oversight and the features of government-approved EDR schemes to which consumers can turn should they be unhappy with the resolution of complaints via the internal dispute resolution schemes of financial services licensees. The chapter ends with the view of the committee concerning the EDR system.

3.3 It should be noted that the three EDR schemes that existed for most of the course of this inquiry merged and were replaced by the Australian Financial Complaints Authority on 1 November 2018.¹

Legislation

3.4 Australia's consumer protection system for the banking, insurance and financial sectors is underpinned by legislation intended to regulate the relevant industries. This legislation sets out:

- how entities are required to engage and interact with consumers;
- how disputes between consumers and entities should be resolved; and
- the powers of government-established bodies responsible for oversight and external dispute resolution.

3.5 The primary pieces of Commonwealth legislation setting out consumer rights and obligations for entities include, among others, the *Corporations Act 2001* (Corporations Act) and the Australian Consumer Law, as set out in the *Competition*

1 In March 2018, the *Treasury Laws Amendment (Putting Consumers First – Establishment of the Australian Financial Complaints Authority) Act 2018* was enacted to create the Australian Financial Complaints Authority (AFCA). See *Corporations Act 2001*, Sect 761A; and the Hon Kelly O'Dwyer MP, Minister for Revenue and Financial Services, 'Putting Consumers First: Australian Financial Complaints Authority Takes Shape', *Media release*, 1 May 2018. See also Australian Financial Complaints Authority, *About AFCA*, <https://www.afca.org.au/about-afca/> (accessed 1 November 2018).

and Consumer Act 2010.² The Corporations Act requires financial services licensees with retail clients to have an internal dispute resolution system in place, to hold adequate professional indemnity insurance and to be a member of at least one EDR scheme approved by the Australian Securities and Investments Commission (ASIC).³

3.6 Other legislation that sets out consumer protections in specific industries or areas of the banking, insurance and financial sector includes:

- *National Consumer Credit Protection Act 2009*, which also includes the National Credit Code
- *Superannuation (Resolution of Complaints) Act 1993*
- *Superannuation Industry (Supervision) Act 1993*
- *Insurance Contracts Act 1984*
- *Insurance Act 1973*
- *Life Insurance Act 1995*.⁴

Government bodies responsible for oversight

3.7 Three government-established bodies are responsible for ensuring that industry complies with legislation and regulations governing the banking, insurance and financial services sector. Two of these, ASIC and the Australian Prudential Regulation Authority (APRA), were established in 1998 in response to the 1997 Financial System Inquiry, which proposed the creation of a dual regulatory system with APRA responsible for prudential regulation and ASIC responsible for regulating corporations, financial market integrity and financial consumer protection.⁵ The third body, the Australian Taxation Office, is responsible for regulating self-managed super funds.⁶

3.8 It should be noted that the Australian Competition and Consumer Commission (ACCC) is responsible for promoting competition and fair trading and provision of

2 Australian Consumer Law, *Legislation: The Australian Consumer Law*, <http://consumerlaw.gov.au/the-australian-consumer-law/legislation/> (accessed 30 October 2018).

3 *Corporations Act 2001*, para 912A(2)(c); Corporations Regulations, section 7.6.02AAA(1).

4 For a complete list, see APRA, *Enabling legislation*, <https://www.apra.gov.au/enabling-legislation> (accessed 30 October 2018); Australian Securities and Investments Commission, *Laws we administer*, <https://asic.gov.au/about-asic/what-we-do/laws-we-administer/> (accessed 30 October 2018).

5 Australian Institute of Superannuation Trustees (AIST), *Submission 9*, pp. 13–14; Stan Wallis, *Financial System Inquiry*, March 1997, Recommendations 1 and 31.

6 Australian Taxation Office, *How your SMSF is regulated*, 16 June 2015, <https://www.ato.gov.au/Super/Self-managed-super-funds/Administering-and-reporting/How-we-help-and-regulate-SMSFs/How-your-SMSF-is-regulated/> (accessed 30 October 2018).

consumer protection in financial markets as a whole.⁷ Primary responsibility for oversight and regulatory activities in relation to consumer protections in the corporate, credit and financial services sector rests with ASIC. Because of the overlap of their activities, ASIC and the ACCC have a memorandum of understanding in place to share information and consult where appropriate on 'recent judgements, current law reform, policy issues, media releases and other matters of mutual interest'.⁸

Australian Prudential Regulation Authority (APRA)

3.9 APRA is the prudential regulator of the Australian financial services industry – that is, its role is to ensure that financial entities are able to manage risks and have sufficient capital to meet their obligations.⁹ APRA is responsible for prudential supervision of all authorised deposit-taking institutions (including banks, building societies and credit unions), private health insurers, life and general insurance companies, and most of the superannuation industry, excluding self-managed superannuation funds.¹⁰

Australian Securities and Investments Commission (ASIC)

3.10 ASIC was established under the *Australian Securities and Investments Commission Act 2001*. ASIC described itself as 'Australia's corporate, markets, financial services and consumer credit regulator'. Its primary purpose is to monitor and promote 'market integrity and consumer protection in relation to the Australian financial system'.¹¹

3.11 ASIC's functions include:

- protecting consumers from poor conduct;
- sanctioning or removing individuals or firms that breach the law in ways that harm consumers; and
- providing consumers with information that will help them to make better financial decisions.¹²

7 *Memorandum of Understanding between the Australian Securities and Investments Commission and the Australian Competition and Consumer Commission*, p. 1, <https://download.asic.gov.au/media/2065149/mou-acc-asic.pdf> (accessed 30 October 2018).

8 *Memorandum of Understanding between the Australian Securities and Investments Commission and the Australian Competition and Consumer Commission*, p. 2, <https://download.asic.gov.au/media/2065149/mou-acc-asic.pdf> (accessed 30 October 2018).

9 APRA, *About APRA*, <https://www.apra.gov.au/about-apra> (accessed 30 October 2018); Treasury, *Australian Prudential Regulation Authority: Section 1: Agency Overview and Resources*, Portfolio Budget Statements 2011–12, <https://treasury.gov.au/publication/portfolio-budget-statements-2011-12/portfolio-budget-statements-2011-12/australian-prudential-regulation-authority/> (accessed 30 October 2018).

10 APRA, *Industry supervision*, <https://www.apra.gov.au/supervision> (accessed 30 October 2018).

11 Australian Securities and Investments Commission (ASIC), *Submission 36*, p. 3.

12 Australian Securities and Investments Commission (ASIC), *Submission 36*, p. 3.

3.12 ASIC requires the internal dispute resolution procedures of financial services entities to meet particular standards or requirements that ASIC sets, such as maximum timeframes to resolve disputes.¹³

3.13 Where ASIC discovers breaches of the law and misconduct on the part of entities, it may negotiate outcomes with industry, such as an enforceable undertaking, or 'a written undertaking...that an entity or person will operate in a certain way'. It is also able to take the following measures:

- enforcement action, including criminal action;
- civil action, such as civil penalty proceedings; and
- administrative action, such as banning or disqualifying individuals from the financial services sector.¹⁴

3.14 ASIC is empowered to take compensatory action, or recover compensation on behalf of consumers. However, ASIC stated in its submission that 'recovery of compensation is ordinarily left to private litigation and class actions'.¹⁵ ASIC can undertake a class action to obtain compensation for a group of consumers or investors who have suffered loss from the same type of misconduct, if it determines that it is in the public interest to do so.¹⁶

3.15 ASIC emphasised that its 'regulatory role does not involve preventing all consumer losses or ensuring full compensation for consumers in all instances where losses arise'.¹⁷ In some instances, ASIC may make a determination requiring a firm to pay compensation for consumer losses, but the firm may be insolvent and unable to pay.

3.16 Until 1 November 2018, with the establishment of the Australian Financial Complaints Authority, ASIC was also responsible for oversight of two EDR schemes: the Financial Ombudsman Service and the Credit and Investments Ombudsman. These are outlined later in this chapter. ASIC's oversight of these schemes did not extend to reviews of individual cases or scheme decisions.¹⁸

Australian Financial Services scheme

3.17 ASIC administers the Australian financial services (AFS) scheme, which requires all businesses providing financial services to hold an AFS licence, except authorised representatives of AFS licensees and those with exemptions.

13 Australian Securities and Investments Commission, *Regulatory Guide 165: Licensing: Internal and External Dispute Resolution*, February 2018.

14 Australian Securities and Investments Commission (ASIC), *Submission 36*, pp. 4–5.

15 Australian Securities and Investments Commission (ASIC), *Submission 36*, p. 5, 97.

16 Australian Securities and Investments Commission (ASIC), *Submission 36*, p. 73.

17 Australian Securities and Investments Commission (ASIC), *Submission 36*, p. 71.

18 Australian Securities and Investments Commission (ASIC), *Submission 36*, p. 62.

3.18 As outlined above, all AFS licensees, as well as credit licensees and trustee companies, must have in place:

- (a) a dispute resolution system, which includes an IDR [internal dispute resolution] procedure and membership of an ASIC-approved EDR scheme; and
- (b) arrangements for compensating retail clients and consumers for loss or damage due to breaches of the financial services or credit laws. Unless the licensee is exempt (i.e. because they are prudentially regulated) they must generally hold adequate professional indemnity insurance cover.¹⁹

External dispute resolution schemes

3.19 The two non-government ASIC-approved EDR schemes, prior to November 2018, were the Financial Ombudsman Service (FOS) and the Credit and Investments Ombudsman (CIO). A third scheme, the Superannuation Complaints Tribunal (SCT), was not subject to ASIC oversight.²⁰ In the second half of 2018, existing EDR schemes shifted to the Australian Financial Complaints Authority, which began receiving complaints on 1 November 2018. The evidence received in this inquiry concerned the prior schemes; as such, the following section begins by describing the functions of FOS, CIO and the SCT, before outlining the details of the new scheme.

3.20 The ability of consumers to make a complaint to a particular scheme depended on which scheme the particular financial services provider or credit service provider had joined.²¹

3.21 Between them, FOS and CIO dealt with around 40,000 disputes each year. ASIC's oversight of the two schemes focused on determining whether 'they operate[d] in accordance with the principles of independence, fairness, efficiency, effectiveness, and accountability', and did not involve ASIC reviewing individual cases or scheme decisions.²²

Financial Ombudsman Service (FOS)

3.22 FOS, as of April 2017, handled 87 per cent of complaints lodged with the three EDR bodies. Its jurisdiction covered 99 per cent of the categories of dispute.²³

3.23 FOS was based on an industry Ombudsman model and funded by industry, with an independent board of consumer representatives and financial services industry

19 Australian Securities and Investments Commission (ASIC), *Submission 36*, p. 62.

20 Australian Securities and Investments Commission (ASIC), *Submission 36*, p. 63; Australian Securities and Investments Commission (ASIC), *Regulatory Guide 139: Approval and Oversight of External Dispute Resolution Schemes*, June 2013, p. 5.

21 Australian Securities and Investments Commission (ASIC), *Submission 36*, p. 73.

22 Australian Securities and Investments Commission (ASIC), *Submission 36*, p. 62.

23 Mr Shane Tregillis, Chief Ombudsman, Financial Ombudsman Service Australia, *Senate Hansard*, 26 April 2017, p. 27.

representatives monitoring its performance.²⁴ FOS outlined in its submission to the 2016 Review of the Financial System External Dispute Resolution Framework that industry Ombudsman models aim to provide 'independent, impartial and fair resolution of disputes arising from contracts and transactions between consumers and private businesses'. Such a model, FOS argued, provided consumers with accessible and free alternative sources of dispute resolution to courts.²⁵

3.24 FOS only dealt with disputes valued \$500,000 or less. Its compensation cap as of 1 January 2018 was \$323,500 for all disputes except general insurance broking (\$174,000), income stream life insurance (\$8,700 per month) and uninsured third party motor vehicle claims (\$5,000). There was also a cap on consequential financial losses of \$3,500 per claim and a cap on non-financial losses of \$3,000.²⁶

3.25 Mr Shane Tregillis, the Chief Ombudsman of FOS, emphasised that in the first instance, customers dealt directly with internal dispute resolution systems of the financial entities with which they had a dispute:

It is sometimes forgotten that FOS is not the primary resolver of customer complaints in the financial sector. This is the role of the financial services firms dealing directly with their customers. We continue to subscribe to the view that it is better for both parties if firms can resolve disputes and problems directly with their customers. Of course, it is even better to deal with the root causes of customer problems to avoid them occurring in the first place.²⁷

3.26 FOS outlined on its website that between 1 January 2010 and 31 December 2016, 35 financial service providers were unwilling or unable to comply with 143 FOS determinations, affecting 203 customers. Consumers received no payments at all from 105 determinations that FOS made in their favour. Slightly more than \$13 million of unpaid determinations remained outstanding. More than half (57 per cent) of non-compliant financial service providers were financial planners and advisers, followed by operators of managed investment schemes (11 per cent) and credit providers (9 per cent).²⁸

24 Financial Ombudsman Service Australia, *Our board*, <http://fos.org.au/about-us/our-board/> (accessed 26 June 2018).

25 Financial Ombudsman Service Australia, *Submission to Review of the Financial System External Dispute Resolution Framework*, October 2016, <http://fos.org.au/custom/files/docs/fos-submission-to-edr-review.pdf> (accessed 30 October 2018), p. 12.

26 Financial Ombudsman Service Australia, *Fact Sheet: How FOS Resolves Disputes and Our Terms of Reference*, https://www.fos.org.au/custom/files/docs/fact_sheet_our_dispute_process_and_terms_of_refere_ncepdf.pdf (accessed 30 October 2018), p. 2.

27 Mr Shane Tregillis, Chief Ombudsman, Financial Ombudsman Service Australia, *Senate Hansard*, 26 April 2017, p. 26.

28 Financial Ombudsman Service Australia, *The Financial Ombudsman Service Circular: Unpaid determinations update*, Issue 28 – February 2017, <https://www.fos.org.au/fos-circular-28-home/fos-news/unpaid-determinations-update/> (accessed 30 October 2018).

3.27 Mr Tregillis noted in the April 2017 hearing that the inability of firms to pay compensation to victims of misconduct as determined in FOS decisions affected the reputation of the entire EDR system:

...we have something like \$13 million of unpaid determinations, largely because the firms involved have gone into administration or insolvency. It undermines credibility in the system if you are able to access dispute resolution and get compensation in your favour but you do not get paid.²⁹

3.28 Financial service providers were unable to pay for a range of reasons. For example, some were in administration or liquidation, or had insufficient funds to meet their obligations. FOS stated that 'Our experience is that professional indemnity insurance isn't an adequate compensation mechanism for consumers where companies have gone into administration or are insolvent'.³⁰

Credit and Investments Ombudsman (CIO)

3.29 CIO operated mainly in the credit sector, as insurers and banks were generally members of FOS. Like FOS, CIO was funded by industry membership and fees levied on its members. CIO's members included mortgage brokers, non-bank lenders, small amount lenders and time share operators, most of which were sole traders and small businesses.³¹

3.30 Similarly to FOS, CIO had a claim limit of \$500,000, and its monetary compensation limits for complaints, as of 1 January 2018, was \$323,500.³²

3.31 As of November 2016, CIO had unpaid determinations worth approximately \$414,443.³³ CIO noted in its submission to the Review into Dispute Resolution and Complaints Framework that over 80 per cent of its unpaid determinations resulted from two determinations against a single mortgage broker.³⁴

Superannuation Complaints Tribunal (SCT)

3.32 The SCT dealt with complaints against trustees and particular insurers as outlined in the *Superannuation (Resolution of Complaints) Act 1993*. It reviewed

29 Mr Shane Tregillis, Chief Ombudsman, Financial Ombudsman Service Australia, *Committee Hansard*, 26 April 2017, p. 30.

30 Financial Ombudsman Service Australia, *The Financial Ombudsman Service Circular: Unpaid determinations*, Special issue – April 2014, <https://www.fos.org.au/the-circular-special-issue-april-2014/fos-forum/unpaid-determinations/> (accessed 30 October 2018).

31 Credit and Investments Ombudsman Limited, *Submission 67*, pp. 1–2.

32 Credit & Investments Ombudsman, *CIO rules*, <https://www.cio.org.au/about-us/cio-rules.html> (accessed 27 June 2018); Credit and Investments Ombudsman Limited, *Credit and Investments Ombudsman Rules*, 10th edition, 15 August 2016, p. 7.

33 Australian Securities and Investments Commission (ASIC), *Submission 36*, p. 98.

34 Credit & Investments Ombudsman, *Submission to Review into Dispute Resolution and Complaints Framework*, pp. 6–7, <https://www.cio.org.au/assets/27886928/Submission%20-%20Last%20Resort%20Compensation%20Scheme%20-%20June%202017.pdf> (accessed 30 October 2018).

decisions and the conduct of superannuation providers of regulated superannuation funds, annuities and deferred annuities, and retirement savings accounts.³⁵ There was no limit on the monetary value of claims brought to the SCT.³⁶

3.33 The SCT was not required to provide ASIC with regular operational and disputes data, as ASIC was not responsible for oversight of the SCT, although ASIC noted that it did regularly meet with the SCT.³⁷

3.34 An issues paper released by the Treasury in September 2016 stated that because of 'the nature of prudential regulation in the superannuation system, the SCT does not have any unpaid determinations'.³⁸

Australian Financial Complaints Authority (AFCA)

3.35 In March 2018, the *Treasury Laws Amendment (Putting Consumers First – Establishment of the Australian Financial Complaints Authority) Act 2018* was enacted to create the Australian Financial Complaints Authority (AFCA). The AFCA replaced the SCT, FOS and the CIO and, as of 1 November 2018, deals with all consumer complaints about products and services provided by financial entities. AFCA is regulated by ASIC.³⁹

3.36 AFCA has the following monetary limits on complaints:

- a monetary limit of \$1 million per complaint except for complaints concerning superannuation, credit facilities provided to a small business where this complaint is lodged by a borrower (see below), and complaints to set aside a guarantee supported by security over the guarantor's primary place of residence; and
- a monetary limit of more \$5 million for complaints about a small business credit facility.⁴⁰

35 Superannuation Complaints Tribunal, *What we do*, <http://www.sct.gov.au/pages/about-us/what-we-do> (accessed 30 October 2018).

36 Australian Securities and Investments Commission (ASIC), *Submission 36*, p. 73.

37 Australian Securities and Investments Commission (ASIC), *Submission 36*, p. 63; Australian Securities and Investments Commission (ASIC), *Regulatory Guide 139: Approval and Oversight of External Dispute Resolution Schemes*, June 2013, p. 5.

38 The Treasury, *Review of the Financial System External Dispute Resolution Framework: Consultation on the Financial System External Dispute Resolution Framework*, September 2016, p. 24

39 Parliamentary Library, *Bills Digest No. 55, 2017–18: Treasury Laws Amendment (Putting Consumers First – Establishment of the Australian Financial Complaints Authority) Bill 2017*, 4 December 2017, p. 5.

40 Australian Financial Complaints Authority (AFCA), *Complaints Resolution Scheme Rules*, 1 November 2018, <https://www.afca.org.au/custom/files/docs/20180920-afca-rules.pdf> (accessed 30 October 2018), pp. 26–27.

3.37 AFCA has the following monetary limits that may be awarded for complaints other than superannuation complaints, which will be subject to indexation on 1 January 2021 and every three years after:

- Claims on life insurance or general insurance concerning income stream risk or advice about such a contract: \$13,400 per month;
- General insurance broking: \$250,000;
- Uninsured motor vehicle: \$15,000;
- Credit facility: variable, depending on the type of complainant and the type of loan;
- All other direct financial loss claims, excluding superannuation complaints: \$500,000;
- Claims for indirect financial loss: \$5,000; and
- Claims for non-financial loss: \$5,000.⁴¹

3.38 There is no monetary limit on the amount that may be awarded to a complainant who has made a superannuation complaint.⁴²

Committee view

3.39 The evidence provided to this inquiry about consumers' experiences with external dispute resolution (EDR) schemes concerned the three prior EDR schemes that existed when the inquiry took evidence: the Financial Ombudsman Service (FOS), the Credit and Investments Ombudsman (CIO) and the Superannuation Complaints Tribunal (SCT). Most submissions outlining issues with the current EDR system were related to FOS determinations.

3.40 The committee notes that in response to the recommendations of the 2017 Ramsay review of the external dispute resolution and complaints framework in the financial system, the government has established the Australian Financial Complaints Authority, which began receiving complaints on 1 November 2018.

3.41 The effectiveness of this new body, combining the work of FOS, CIO and the SCT, remains to be seen. The committee reserves its opinion, but notes that multiple previous inquiries, as well as much of the evidence in this inquiry, outlined significant concerns regarding the prior EDR schemes. It is hoped that the new scheme has taken steps to prevent similar concerns arising.

3.42 It should be remembered that if the financial sector as a whole were more robust in terms of its consumer protections, and if non-compliance with regulatory

41 Australian Financial Complaints Authority (AFCA), *Complaints Resolution Scheme Rules*, 1 November 2018, <https://www.afca.org.au/custom/files/docs/20180920-afca-rules.pdf> (accessed 30 October 2018), p. 35.

42 Australian Financial Complaints Authority (AFCA), *Complaints Resolution Scheme Rules*, 1 November 2018, <https://www.afca.org.au/custom/files/docs/20180920-afca-rules.pdf> (accessed 30 October 2018), p. 31.

requirements and unethical behaviour were rare exceptions to a culture of putting the interests of the consumer first, demands for any EDR body would be reduced. The work of this committee and of the Financial Services Royal Commission indicates the extent of misconduct and unethical behaviour on the part of financial service providers over the course of many years, despite reassurances to the contrary. EDR schemes are often a last resort for consumers unable to afford legal proceedings, and the evidence provided to this inquiry suggested that most consumers, when faced with the resources of large financial entities, do not choose to initiate legal proceedings in any case. EDR schemes should not work as a 'band-aid' to patch up a leaky broken system, but rather work effectively with regulation and penalties to ensure that financial entities are behaving ethically and according to the requirements of the law, and are incentivised to do so.